

103 KAR 16:230. Intangible expenses, intangible interest expenses, and management fees.

RELATES TO: KRS 131.130, 141.205

STATUTORY AUTHORITY: KRS 131.130(1)

NECESSITY, FUNCTION AND CONFORMITY: KRS 131.130(1) authorizes the Department of Revenue to promulgate administrative regulations necessary to administer and enforce Kentucky's tax laws. KRS 141.205 disallows intangible expenses, intangible interest expenses and management fees when those expenses and fees are directly or indirectly paid, accrued or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with one or more related members or with a foreign corporation, unless certain criteria are met. This administrative regulation establishes the requirements for when these expenses and fees are allowed or disallowed.

Section 1. Definitions. (1) "Actual comparables" means transactions between the recipient and unrelated parties that are identical to the subject transaction.

(2) "Comprehensive income tax treaty" means a convention, or agreement, entered into by the United States, and approved by Congress, with a foreign government for the allocation of all categories of income subject to taxation or the withholding of tax on interest, dividends, and royalties, in order to prevent double taxation of the respective nations' residents, and to promote the sharing of information.

(3) "Measured by, in whole or in part, net income" means that the receipt of the payment by the recipient is reported and included in income for purposes of a tax on net income or in the franchise for purposes of the franchise tax.

(4) "Reported and included in income for purposes of a tax on net income or in the franchise," means:

(a) For a tax on net income, reported and included in the net income apportioned or allocated to the taxing jurisdiction; or

(b) For a franchise tax, reported and included in the franchise apportioned or allocated to the taxing jurisdiction.

(5) "Subject transaction" means the transaction giving rise to the intangible expense, intangible interest expense, or management fee.

Section 2. Disclosure; General. As part of the required disclosure, the entity shall provide a description of the nature of the payment made to the recipient. This description shall contain:

(1) For intangible expenses or intangible interest expenses:

(a) A narrative regarding the subject transaction;

(b) The extent of the rights being transferred, for example, if a patent is being licensed:

1. Whether that license is exclusive or non-exclusive; and

2. Whether the transferee has any rights to sublicense;

(c) How the amount of the payment is calculated; and

(d) If there is a document that sets forth the terms of the subject transaction, a copy of that document; and

(2) For management fees:

(a) A narrative of the services being performed for the entity by the recipient;

(b) How the amount of the payment is calculated; and

(c) If there is a document that sets forth the terms of the transaction, a copy of that document.

Section 3. Disclosure; Arm's Length Transaction. An entity may be required to establish that the subject transaction was made at a commercially reasonable rate and at terms comparable to an arm's length transaction.

(1) If there are actual comparables, the actual comparables shall be used.

(2) If there are no actual comparables, the two (2) primary factors to take into account if determining whether the subject transaction was made at a commercially reasonable rate and at terms comparable to an arm's length transaction shall be:

(a) The degree of comparability between the subject transaction and the proposed comparable transactions; and

(b) The quality of the data and assumptions used in the analysis.

Section 4. Disclosure; Intangible Expense, Intangible Interest Expense, or Management Fee. With respect to an intangible expense, intangible interest expense, or management fee, the entity shall make additional disclosures if it cannot utilize any of the other methods to establish that it is entitled to the deduction. The entity shall show that the payment made to the recipient was subject to, in its state or country of commercial domicile, a net income tax, or a franchise tax, measured by, in whole or in part, net income. If the recipient is a foreign corporation, the foreign nation shall have in force a comprehensive income tax treaty with the United States.

Section 5. Corporation or Pass-Through Entity. A corporation or pass-through entity that during the taxable year directly or indirectly paid, accrued, or incurred intangible expenses, intangible interest expenses, or management fees to a related member or foreign corporation shall attach to its tax return filed with the department:

(1) Schedule RPC (Form number 41A720RPC), incorporated by reference in 103 KAR 3:040; and

(2) Any additional disclosures required by Sections 2, 3, and 4 of this administrative regulation.

Section 6. The disclosures related to management fees and the provisions of Section 5 of this administrative regulation shall apply to taxable years beginning on or after January 1, 2014. (16 Ky.R. 2614; eff. 7-12-90; Recodified from 103 KAR 7:025, 10-12-2006; 40 Ky.R. 357, 784; eff. 11-1-2013.)